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October 28, 1994

William F. Caton
Acting Secretary
Federal Communications Commission
Washington, D.C. 20554

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OCT 28 1994
FEDERAL COMMUNICATIONS COMMISSION

Re: Ex Parte Meeting
CC Docket No. 94-1
LEC Price Cap Performance Review

Dear Mr. Caton:

On Friday, October 28, 1994, Donald Evans and I met with Kathleen Wallman and members of her staff to discuss MCI's position in the above-captioned docket. The attached served as the basis for our discussion.

An original and one copy of this notice has been submitted to your office on the date of this meeting in conformance with Section 1.1206(a)(2) of the Commission's rules.

Sincerely,

Chris Frentrup
MCI Telecommunications Corp.
Federal Regulatory Affairs

cc: Kathleen Wallman
Kathleen Levitz
Anna Gomez
David Nall
Dan Grosh
Joanne Wall
Mark Uretsky
Alex Belinfante

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PERFORMANCE REVIEW

- The Commission noted that the Performance Review would reconsider all aspects of the price cap plan

"The transition from rate of return to price cap regulation is a complex one, and, while we have made every effort to consider each relevant factor carefully and to base our determinations in reason and experience, some fine-tuning will probably prove necessary."

LEC Price Cap Order, para. 385

"The performance review should provide sufficient information to allow the Commission to reevaluate the need for lower end adjustment and sharing mechanisms, and to adjust the sharing mechanism and productivity factor if necessary. At that time, we will evaluate all aspects of the price cap plan and of LEC performance."

LEC Price Cap Order, para. 394

- Recalibration of the productivity factor or the sharing mechanism does not destroy price cap incentives

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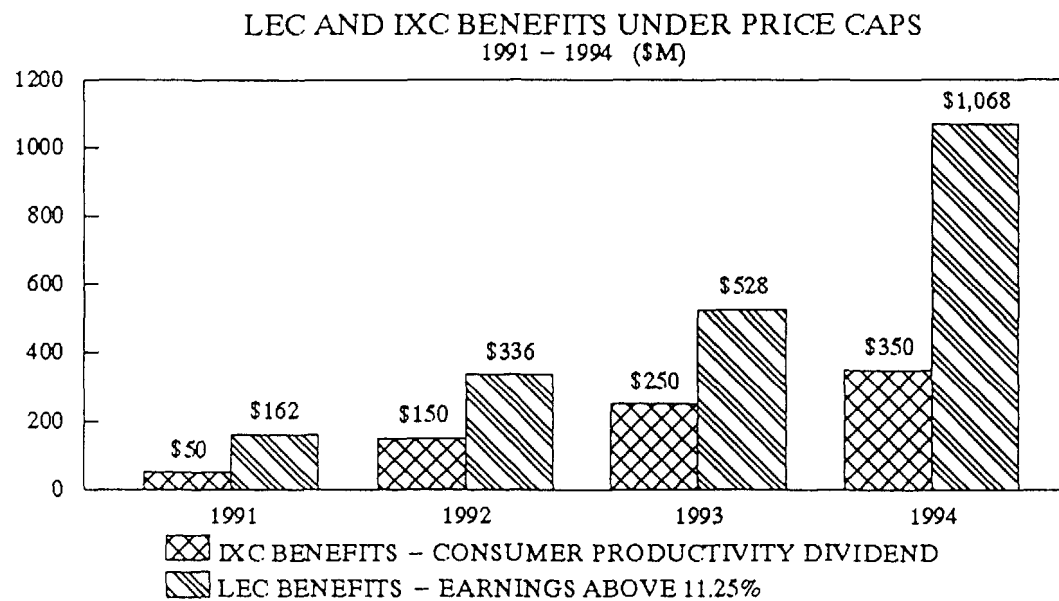
FEDERAL COMMUNICATIONS COMMISSION

LEC WINDFALLS

- Half the growth in CCL minutes of use
- No recalibration of TS Switching rates when the trunking basket was created
- Cost of capital dropped early in the price cap period
- Many unplanned exogenous changes

BENEFITS OF PRICE CAPS

- Benefits of price caps have been overly skewed toward the LECs
- The value to LECs of earnings above 11.25% has exceeded the benefit to the IXC's of the 0.5% Consumer Productivity Dividend



NEEDED CHANGES TO THE PRICE CAP PLAN

- Increase the productivity factor
- Recalibrate rates to reflect lower cost of capital
- Limit future exogenous changes
- Retain sharing

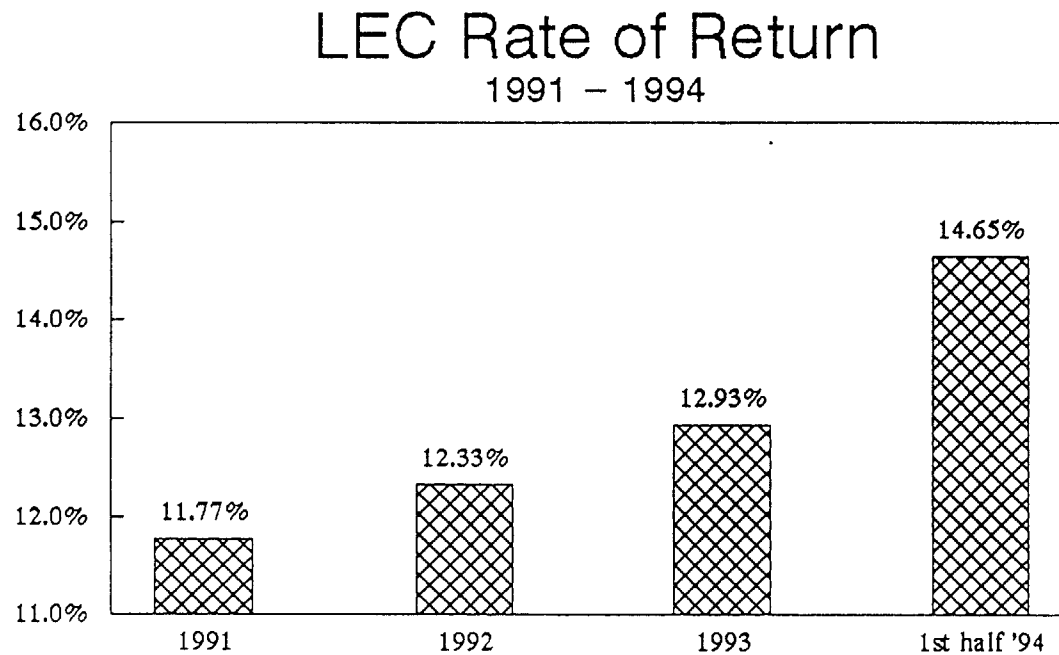
PRODUCTIVITY

- Productivity factor should be increased
- Commission's original choice of productivity factor was a "conservative minimum figure"

LEC Price Cap Order, para. 99.

PRODUCTIVITY (cont'd.)

- LEC earnings have consistently risen under price caps

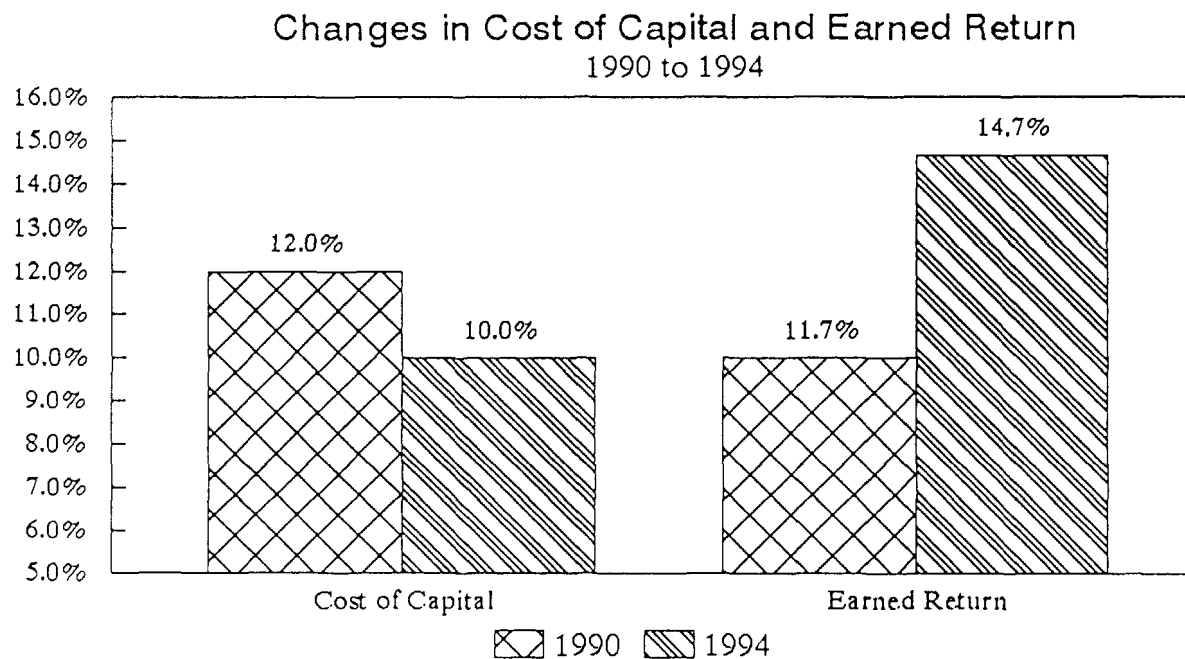


PRODUCTIVITY (cont'd.)

- An X of 5.9% would be consistent with both the original short-term study and the LECs' performance under price caps

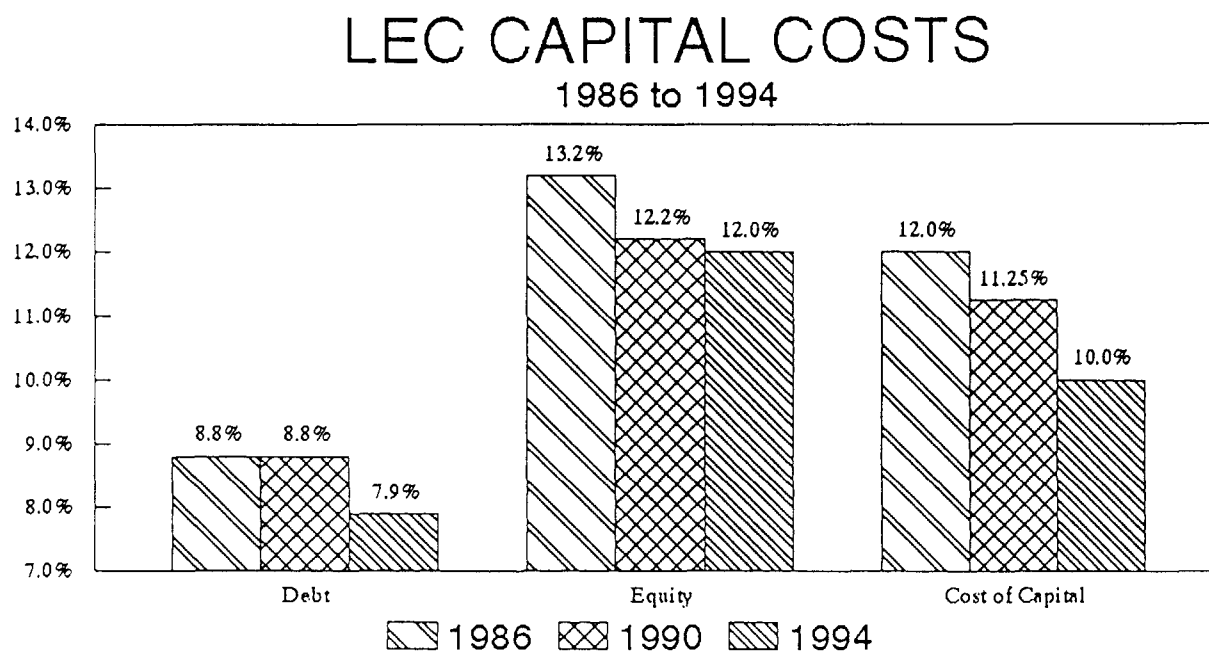
RATE OF RETURN

- Cost of capital has declined since 1990, while earned returns have risen



RATE OF RETURN (cont'd.)

- Updating the Commission's 1990 methodology with data through July 1994, the current cost of capital is 10 percent



RATE OF RETURN (cont'd.)

- Rate of Return changes are not captured in GNPPI – X, because X was set based on studies which held the rate of return constant
- In a competitive industry, firms do not retain reduced costs of capital forever; eventually they must pass through those reduced costs into lower prices

EXOGENOUS CHANGES

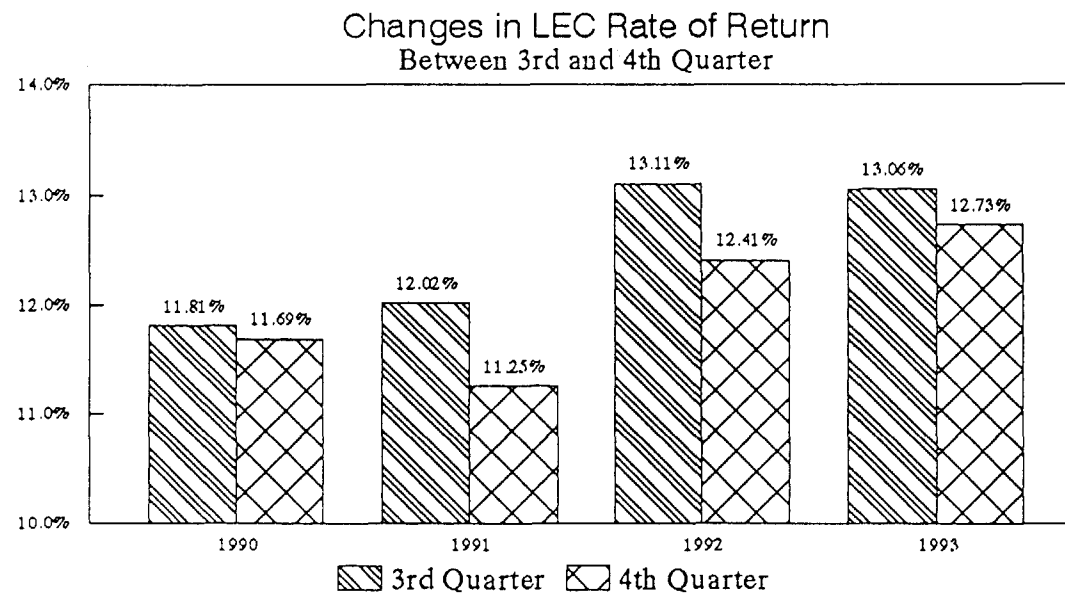
- Additional exogenous changes allowed by the Commission have increased rates by \$274.8 million
 - TRS \$10.6 Million
 - OPEB \$148.3 Million
 - GSF \$7.8 Million
 - 800 DB \$15.3 Million
 - TAXES \$37.4 Million

SHARING

- Sharing should be maintained
 - Without sharing, the Commission lacks any meaningful enforcement mechanism
- The Lower Adjustment Mechanism is redundant
 - LECs can petition for above–cap filings
- Sharing levels should be reset to reflect the current cost of capital

SHARING (cont'd)

- LEC booking of large fourth quarter expenses should be curtailed



SHARING (cont'd)

- LEC booking of large fourth quarter expenses has changed dramatically since price caps began

